

# Taxing Gifts and Inheritances: Options for Reform

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[www.ifs.org.uk/mirrleesreview/](http://www.ifs.org.uk/mirrleesreview/)

# Background

- based on *Taxation of Wealth and Wealth Transfers* by Robin Boadway, Emma Chamberlain and Carl Emmerson
- contribution to the IFS Mirrlees Review, “Reforming the Tax System for the 21st Century” [www.ifs.org.uk/mirrleesreview/](http://www.ifs.org.uk/mirrleesreview/)

# Outline

- UK wealth and wealth transfer taxes much criticised
  - Inheritance tax particularly unpopular?
- These taxes (often) represent double taxation
  - can be justified via standard (welfarist) economic arguments
  - equality of opportunity arguments stronger?
- Inheritance tax reform options:
  - replace with accessions tax
  - more limited reform of existing tax
  - abolish inheritance tax but impose capital gains tax at death

# UK taxes on wealth transfers

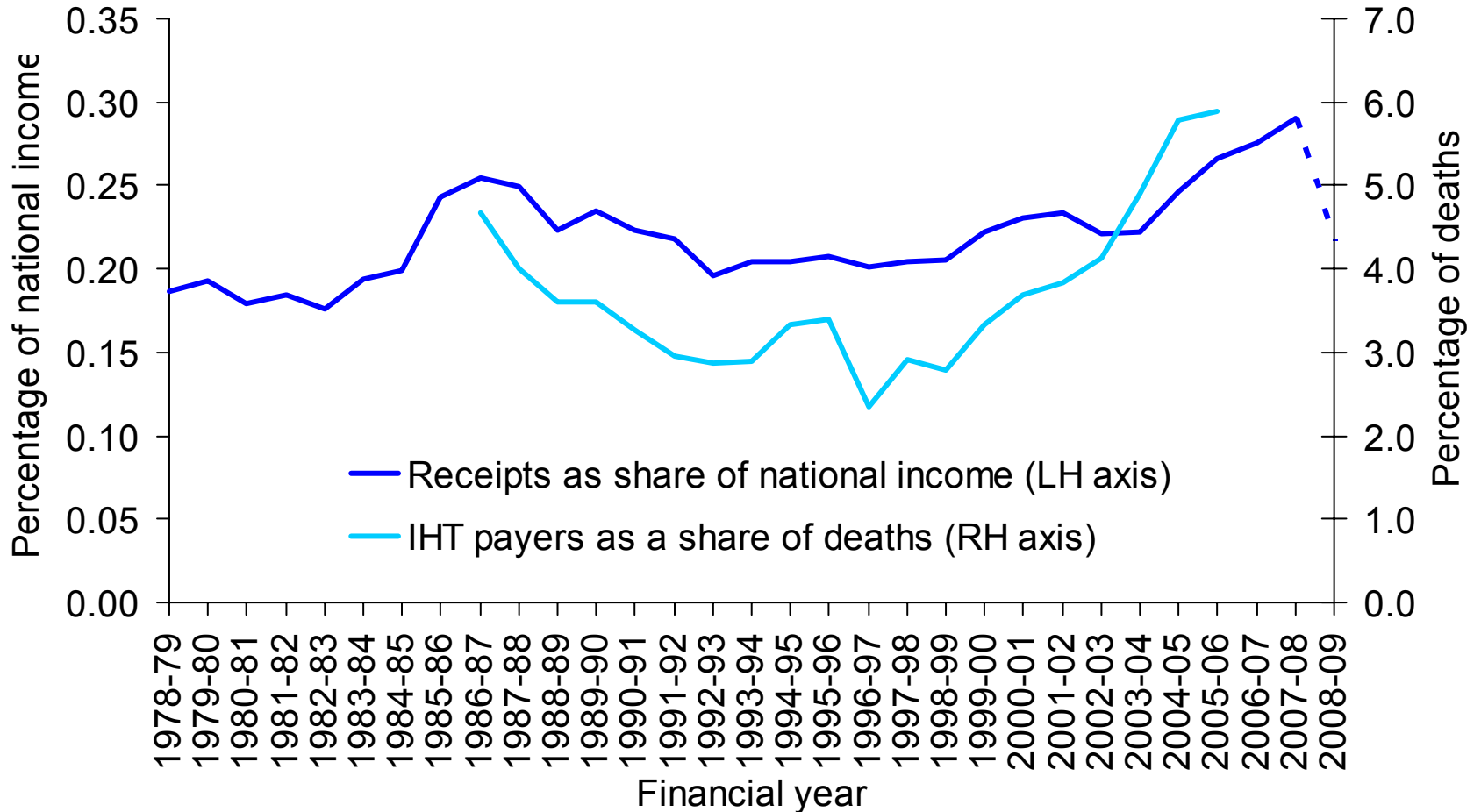
- Inheritance tax
  - estates at death taxed at 40% above £312,000
  - transfers to spouses and UK charities exempt
  - unused allowance inherited by married partner
  - lifetime gifts exempt if donor survives 7 years and gives up all benefit in the gifted asset
  - relief for farms and private businesses
  - some gifts to trusts taxed
- Capital gains tax
  - gifts deemed as realisation unless made on death

# Inheritance tax unpopular

- Raises relatively little revenue
- Paid by the wealthy not the very wealthy

# How significant is UK inheritance tax?

## Inheritance tax and capital transfer tax receipts and payers

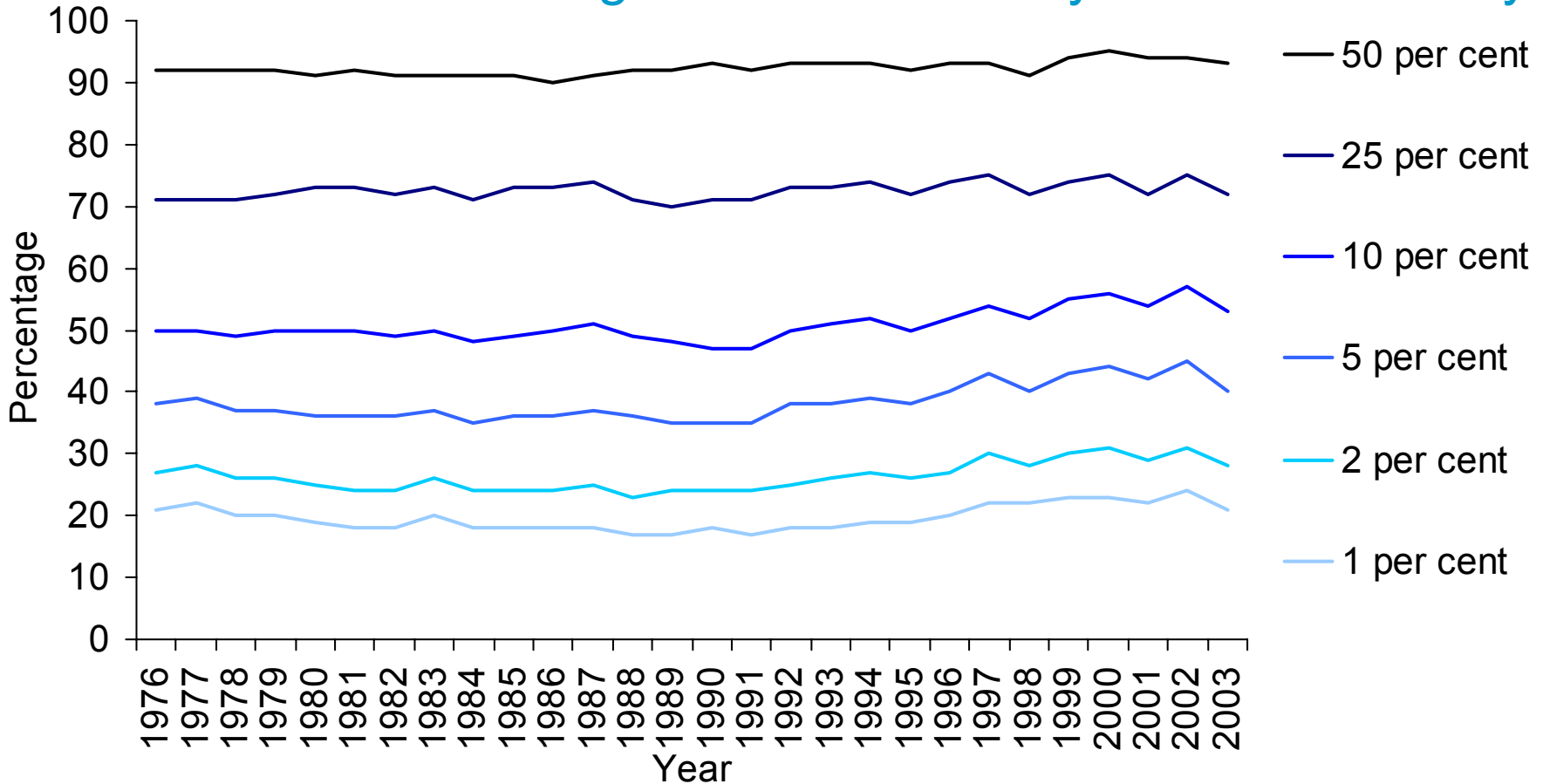


# Inheritance tax unpopular

- Raises relatively little revenue
- Paid by the wealthy not the very wealthy
- Flat rate of 40% too high
- Double taxation
- No effect on wealth distribution

# Concentration of personal wealth

Percentage of wealth held by the most wealthy:





# Inheritance tax unpopular

- Raises relatively little revenue
- Paid by the wealthy not the very wealthy
- Flat rate of 40% too high
- Double taxation
- No effect on wealth distribution
- Not harmonised with capital gains tax

# Guiding principles

- Problems
  - few accepted normative principles
  - no consistent approach across G7
  - optimal tax literature gives little guidance
  - implementation problems significant
- 3 main criteria for evaluating tax system
  - welfarist criterion
  - equality of opportunity
  - paternalism

# Welfarism

- Standard theoretical economic literature approach
  - Government maximises people's welfare, considering behavioural responses and need to finance public services
- Better off pay more tax, with progressivity varying by
  - size of behavioural responses (efficiency)
  - inequality aversion of government (equity)
- General problems
  - measurability; reliance on self-reporting; commitment; collection & compliance costs; societal consensus

# Welfarism & wealth transfers (1)

- Appropriate treatment varies by bequest motive
  - altruism
  - utility of bequest
  - strategic bequest
  - accidental

## Welfarism & wealth transfers (2)

- Should these forms of utility count for tax purposes?
  - donee cares about donor's consumption?
  - donor's utility affected by donee's without transfer?
- Should encourage transfers that benefit others?
- Motive(s) for transfer not observable

# Equality of opportunity & wealth transfers

- Principle of compensation
  - compensate for things beyond control
  - tax receipt of inheritances progressively
- Principle of responsibility
  - no penalty or reward for free choices (e.g. bequests)

# Taxation of wealth transfers

- Welfarism: should welfare gain of both donor and donee count?
  - if yes then double taxation justified; otherwise should only tax once (unless strategic or unintended transfer)
- Equality of opportunity
  - no relief for donors (principle of responsibility)
  - tax donees (principle of compensation)

# Options

- Annual wealth tax – France, Spain, Norway, Switzerland; tax inherited wealth differently?
- Taxing transfers of capital. Consider NZ, Australia, Canada, India, Pakistan
- Capital gains tax due on death?
- Wholesale reform, abolition or improvement?



# Design issues

- International considerations – what is the connecting factor? Double or nil taxation
- Donor/donee based tax?
- Lifetime gifts or death transfers only?
- Rates and thresholds – separate or integrated with income tax system?

# Design issues

- Reliefs and exemptions e.g. houses, spouses, businesses, farms, foreign doms
- Rates and thresholds
- Interaction with capital gains tax
- How should trusts be taxed? Transparent; income beneficiary; fictional taxpayer

# Wholesale reform – wealth tax

- Meade was enthusiastic – promotes equality
- Labour's Green paper in 1974
- Income not a sufficient measure of taxable capacity
- Taxes assets that produce no income that the rich like to own such as pictures
- Outreach

# Wholesale reform – wealth tax

- The taxable unit – the individual or the family?
- Individuals and trusts; companies
- Evasion
- Deductible liabilities
- Residence, domicile, situs

# Wholesale reform – wealth tax

- Valuations
- Some exemptions – on what assets should it be levied? Houses; pensions; not comprehensive
- Liquidity – lifecycle smoothing
- Impose on high net value residential property

# Wholesale reform – wealth tax

- Little effect on wealth distribution
- Expensive to collect
- Deterrent on UK investment
- Constitutional issues

# Donor vs donee based system

- Donor or estate based system – tax by reference to the donor; ignores past inheritance of donee – this is the UK system
- Donee or inheritance based system. CAT in Ireland; Switzerland; civil systems

# Donee based system – pros and cons

- More complex than donor based tax?
- Tax on all lifetime gifts not just on death – cumulative total of inheritances – fairer
- Encourages private redistribution so more equality
- Compliance costs – increasing number of exemptions; record keeping
- Yield; rates – 20% in Ireland
- Transitional provisions; political consensus



# Reform of existing system

- Increase threshold
- Targeted relief for homes
- Rates
- Reliefs – e.g. APR and BPR
- Lifetime gifts
- Foreigners
- Better information by recording lifetime gifts

# Abolition of inheritance tax?

- Recoup revenue by having capital gains tax on death – highlights double taxation
- Have both capital gains tax and inheritance tax on death – they have different objectives
- Simplicity; avoid arbitrary effects
- Family home
- Emigration/immigration
- Businesses; spouses

# Conclusions

- Any reform requires some political consensus
- Consider capital gains tax on death
- If retain inheritance tax put the case more forcibly – reform the tax
- Donee based tax – but is it worthwhile?
- Abolition – combined with the introduction of capital gains tax may not involve loss of revenue
- Different winners and losers

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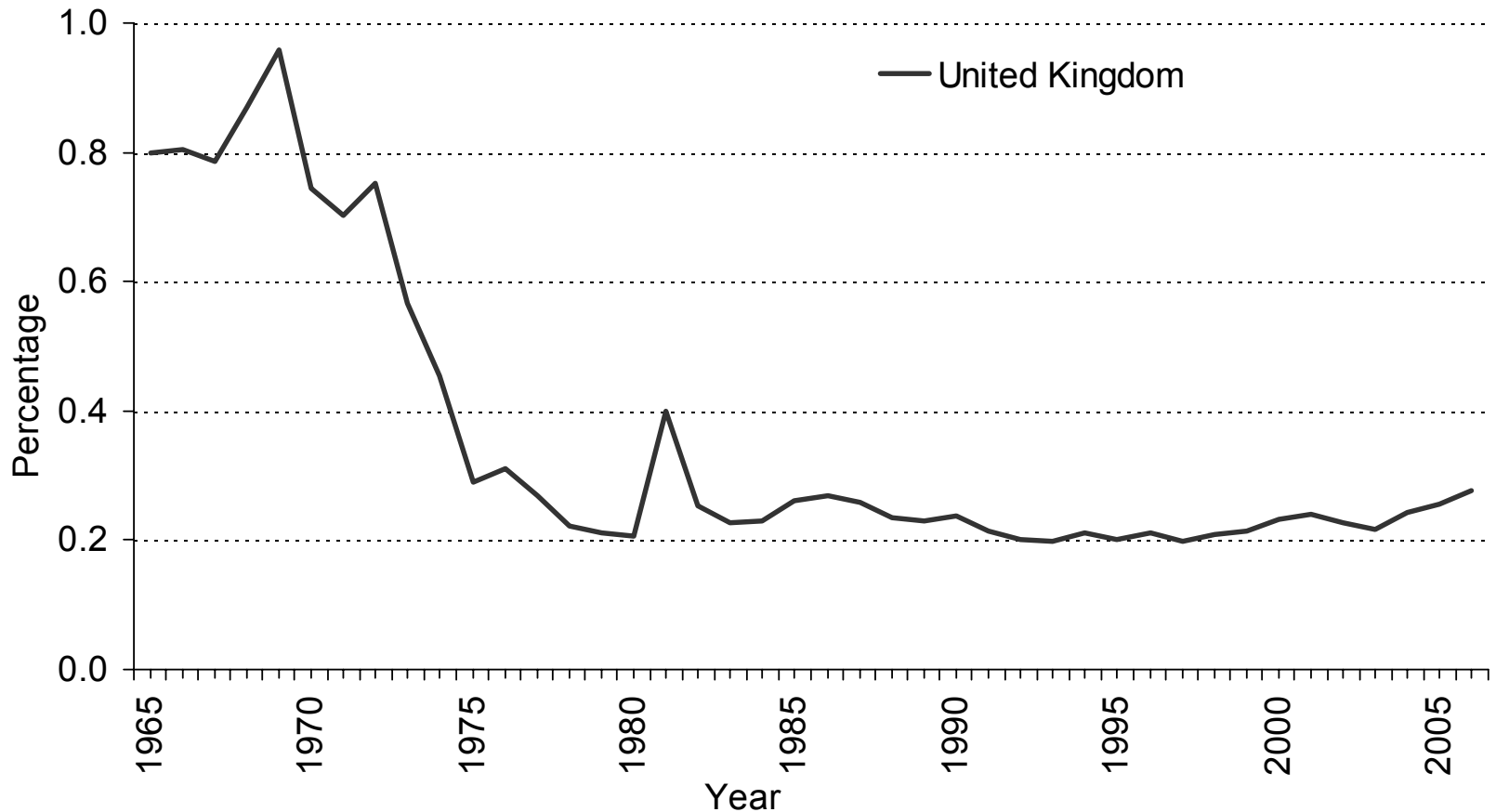
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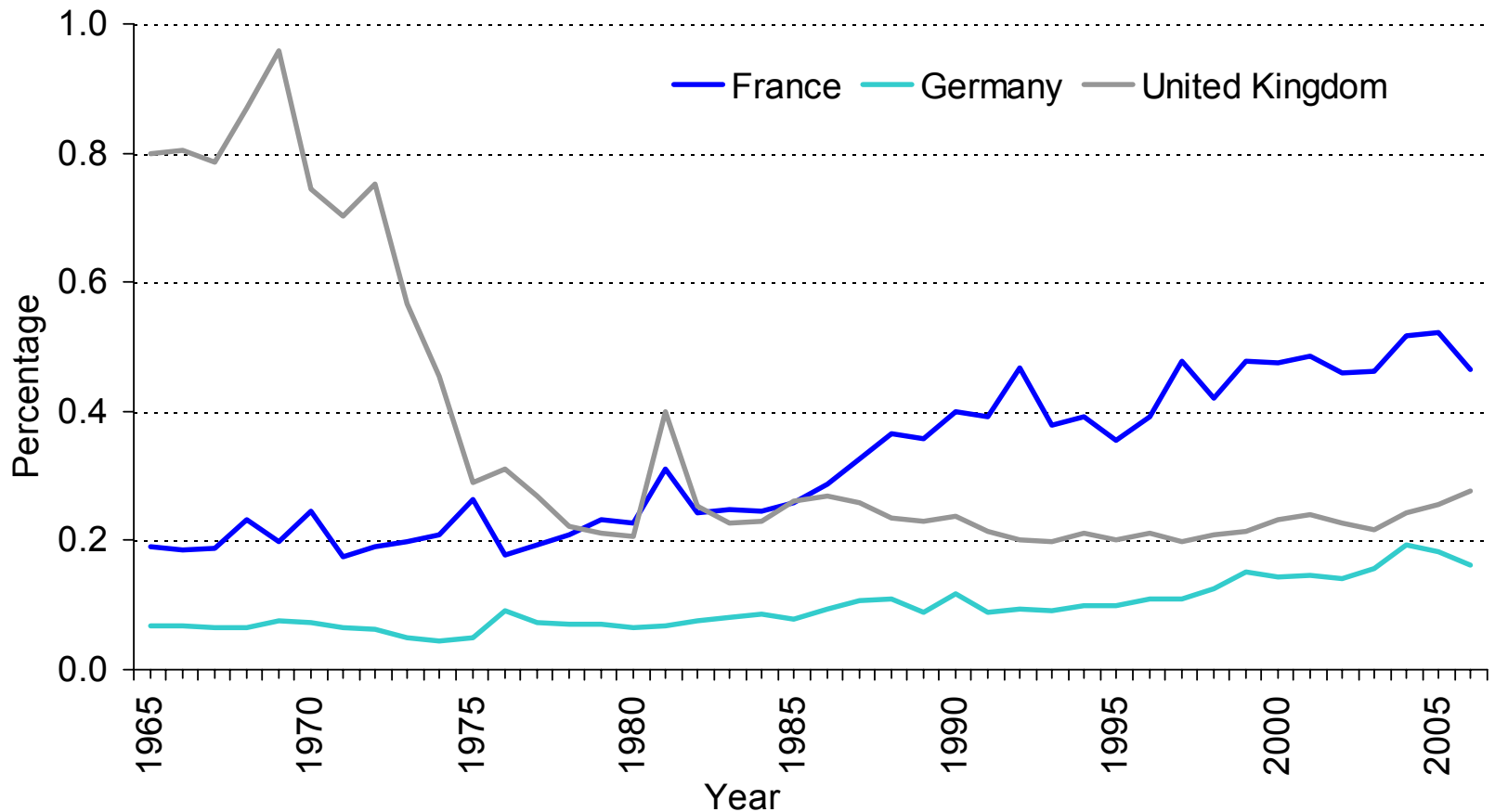
# No consistent G7 approach

## Estate, Inheritance and Gift Tax receipts, 1965 to 2006



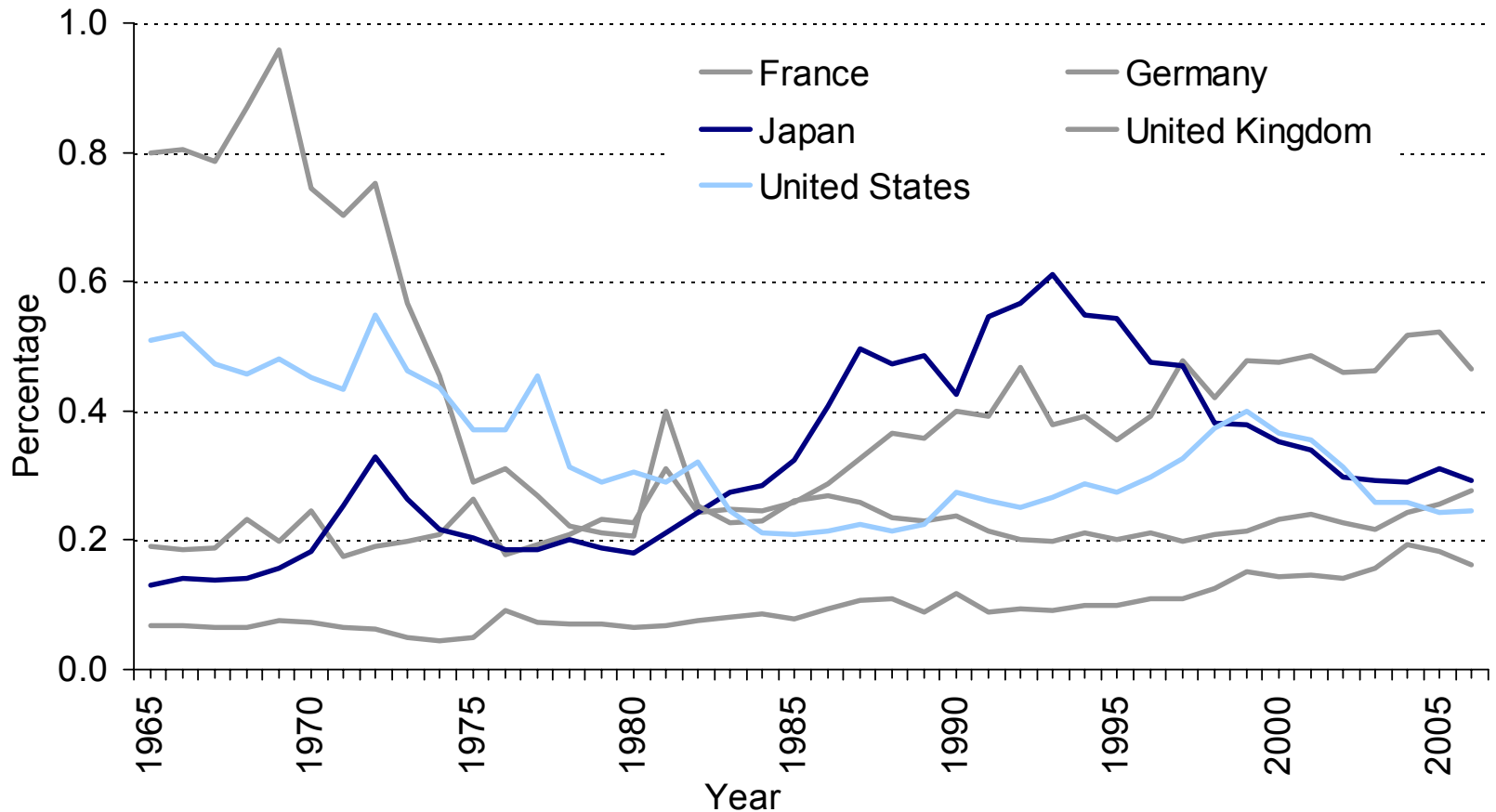
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